

NORTH DAKOTA STATE BONDING FUND

INVESTMENT POLICY STATEMENT

1. FUND CHARACTERISTICS AND CONSTRAINTS.

The State Bonding Fund (the Fund) was established for bonding public employees and public officials in accordance with Chapter 26.1-21 of the North Dakota Century Code (NDCC). Some fees to the Fund are collected annually in the form of claims repayments. However, the primary funding source for the Fund is investment return.

A minimum balance of \$2.5 million must be maintained at all times. If reserves drop below this statutory minimum, premiums will be assessed against all bond holders in accordance with NDCC 26.1-21-09. Such premiums will continue to be charged until the Fund balance reaches \$3.0 million. This situation must be avoided.

Claims paid from the Fund are on an as-needed basis and are highly unpredictable. A judgment against the guilty party is required prior to the Fund making a claim payment. Generally, there is a 60-90 day lead-time to prepare for a claim payment. Claims have averaged \$92,222 annually over the last four fiscal years.

Appropriations from the Fund are exclusively for administrative costs. For planning purposes during the 2003-2005 biennium, these appropriations are assumed to be \$17,500 annually.

The Fund's asset allocation will need to be reviewed at the end of the 2003-2005 biennium for appropriateness.

2. RESPONSIBILITIES AND DISCRETION OF THE STATE INVESTMENT BOARD (SIB)

The SIB is charged by law under NDCC 21-10 with the responsibility of establishing investment policy and investing the assets of the Fund. The assets are to be invested in a manner consistent with the prudent investor rule as provided in NDCC 21-10-07.

At the discretion of the SIB, the Fund's assets may be pooled with other funds. In pooling funds, the SIB may establish appropriate asset class pools designed to provide specific quality and diversification guidelines, restrictions, and performance objectives consistent with the goals of the funds participating in the pools.

The SIB may delegate investment responsibility to professional money managers. When a money manager has been retained, the SIB's role in determining investment strategy and security selection is supervisory, not advisory.

The SIB is responsible for establishing criteria and procedures and making decisions with respect to hiring, maintaining, and terminating money managers. This responsibility includes selecting performance measurement services, consultants, and report formats and determining the frequency of meetings with managers.

3. INVESTMENT OBJECTIVES.

The investment objectives of the Fund reflect the long-term nature of the Fund, but also recognize the shorter-term liquidity needs. Operating and statutory considerations shape the policies and priorities outlined below:

Objective #1: Investment income is needed as a funding source. This will be achieved through a diversified portfolio of high quality fixed income and equity assets.

Objective #2: Growth of capital is needed to provide an inflationary hedge and add to the growth of surplus. Capital growth will be sought through investment in equities and/or equity substitutes.

Objective #3: Sufficient liquidity is to be maintained to meet known or anticipated financial obligations and preserve the value of the surplus. Cash equivalent investments will be used to achieve this objective.

Objective #4: The risk of violating the statutory minimum balance requirement of \$2,500,000 is to be minimized. This will be achieved by an asset allocation consistent with this objective.

4. STANDARDS OF INVESTMENT PERFORMANCE.

The Fund's investment objectives and liquidity constraints give rise to an asset allocation that is considered the most likely to achieve the results desired. For evaluation purposes, the following performance targets will apply:

- a. The Fund should produce a rate of return that meets or exceeds the portfolio policy index defined as 15% S&P 500 domestic stock index, 5% Russell 2000 domestic small cap index, 10% MSCI EAFE international stock index, 10% First Boston Convertible Securities index, 50% Lehman Government/Corporate domestic bond index, and 10% 90-day Treasury bills.

- b. The annual standard deviation of total returns for the Fund should not exceed that of the policy portfolio.

5. POLICY AND GUIDELINES.

The asset allocation of the State Bonding Fund is established by the SIB, with input from the Insurance Department. Asset allocation is based upon the appraisal of projected liquidity and income requirements, and estimates of the investment returns likely to be achieved by the various asset classes over the next five years.

In recognition of these factors, the following allocation is deemed appropriate for the fund:

Large Cap Domestic Equity	15 %
Small Cap Domestic Equity	5 %
Convertible Bonds	10 %
International Equity	10 %
Fixed Income	50 %
Cash Equivalents	10 %

Rebalancing of the Fund to this target will be done in accordance with the SIB's rebalancing policy.

While the SIB is responsible for establishing specific quality, diversification, restrictions, and performance objectives for the investment vehicles in which the Fund's assets will be invested, it is understood that:

- a. No derivative instruments or strategies which make use of derivatives which would cause the portfolio to be in any way leveraged will be used.
- b. Derivative use will be monitored to ensure that undue risks are not taken by the money managers.
- c. All assets will be held in custody by the State Investment Board's master custodian or such other custodians as are acceptable to the State Investment Board.

- d. No funds shall be borrowed.
- e. No short sales or margin purchases shall be made.

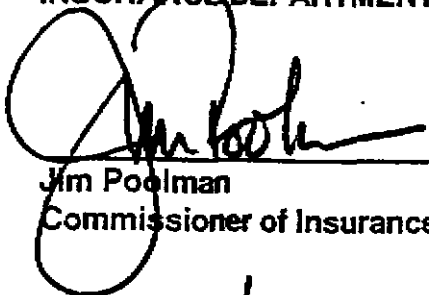
6. EVALUATION AND REVIEW.

Investment management of the Fund will be evaluated in comparison with the Fund's investment objectives and investment performance standards. Evaluation will be conducted quarterly by the SIB through its review of funds participating in the Insurance Trust.

Money managers will be evaluated by the SIB quarterly. In-state meetings will be held with the money managers at least annually.

Approved by:

INSURANCE DEPARTMENT



Jim Poolman
Commissioner of Insurance

Date: 6/24/03

STATE INVESTMENT BOARD



Steve Cochrane
Executive Director/Investment Director, RIO

Date: 6.27.03



ND Retirement and Investment Office

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Memo

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Commissioner of Insurance
State of North Dakota

To: Ken Rood, Insurance Dept Funds
From: Connie Flanagan *CF*
Date: March 2, 2004
Re: Adjustment to Investment Guidelines

We are in the process of reviewing all of the Investment Guideline Statements for the funds invested by the State Investment Board (SIB). We would like to request a change in the language in Section 5 of your statement regarding allowable investments.

In subsection "a." we would like to change the policy "No derivative instruments or strategies which make use of derivatives which would cause the portfolio to be in any way leveraged will be used." We recommend changing it to, "Futures and options may be used to hedge or replicate underlying index exposure, but not for speculation."

In subsection "e." we would like to change the policy "No short sales or margin purchases shall be made." We recommend changing it to, "No unhedged short sales or speculative margin purchases shall be made."

These changes will facilitate the hiring of an additional large cap domestic equity manager who utilizes a futures strategy in an enhanced index portfolio. In the essence of time, we request that you indicate your approval of this change by signing below and returning this memo to us. You may want to keep a copy for your records. We will send out complete revised guidelines statements in the near future.

I approve of the changes indicated above. Signed

Date

Ken Rood
3/4/04